

**MINUTES
REGULAR MEETING
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**Friday, December 16, 2005
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room, 3300 N. Central Avenue, Phoenix, Arizona. Dr. Keith Meredith, Chair of the ASRS Board, called the meeting to order at 8:35 a.m., MST.

The meeting was teleconferenced to the ASRS office at 7660 E. Broadway, Tucson, Arizona 85710.

1. Call to Order; Roll Call; Opening Remarks

Present: Dr. Keith Meredith, Chair
Mr. Karl Polen, Vice Chair
Mr. David Byers
Mr. Jaime Gutierrez
Mr. Chris Harris
Ms. Anne Mariucci
Mr. Michael Townsend
Mr. Lawrence Trachtenberg
Mr. Steven Zeman (via teleconference)

A quorum was present for the purpose of conducting business.

2. Approval of the Consent Agenda

Motion: Mr. Karl Polen moved to approve Refunds, Death Benefits and Retirements;

And

Approve the System Transfers;

And

Approve the minutes of the November 18, 2005, Regular Meeting of the ASRS Board;

And

Approve the Applications and Agreements with the Following Employer;

- Town of Cave Creek

Mr. Michael Townsend seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

3. Approval, Modification or Rejection of Recommended Administrative Law Judge's Decision Regarding Kenneth Scoville

Mr. Kenneth Scoville addressed the Board regarding his appeal. Mr. Scoville's main concerns were that he believed that he was not notified of the appeal process in a timely manner and that his actions were based on faith in the advice of the ASRS staff. Mr. Dave Byers asked if there would have been a difference in Mr. Scoville's hearing if he had been informed of the appeal process in a timelier manner. Mr. Anthony Guarino, Deputy Director, Chief Operations Officer, stated that nothing would have been different.

Motion: Mr. Dave Byers moved to accept the ruling of the Administrative Law Judge with the following exceptions:

1. The agency should be permitted to consider the \$16,687.28 early retirement payment made in fiscal year 2002-03 as wages the member earned in exchange for full-time employment, thus permitting the agency to remain consistent in the treatment of such members and permitting the member to retain the additional year of service he earned for fiscal year 2002-03.
2. Correction to item 13 on page 3 of the Opinion and move that the date be changed from "2003-03" to "2002-03."

Mr. Karl Polen seconded the motion

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

4. Presentation, Discussion and Appropriate Action Regarding the External Auditor Report for FY 2005

The ASRS external auditor, Deloitte & Touche, LLP, issued an unqualified Independent Auditor's Report for the fiscal year ending June 30, 2005 ASRS basic financial statements. Mr. John Maddox, Director, Deloitte & Touche, and Mr. Gregory Lee, Senior Manager, Deloitte & Touche, presented the findings to the Board.

An unqualified report means that the ASRS financial statements present fairly, in all material respects, the net assets of the ASRS as of June 30, 2005, and the changes in net assets for the year ended in conformity with accounting principles generally accepted in the United States of America.

For the third year in a row, Deloitte had no findings or recommendations to make to the ASRS regarding its internal control, accounting, administrative or operating processes.

Motion: Mr. Michael Townsend moved to accept the External Auditor Report for Fiscal Year 2005.

Ms. Anne Mariucci seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

5. Presentation, Discussion and Appropriate Action Regarding Notice of Final Rulemaking for Article 6, Public Participation in Rulemaking

Mr. Jaime Gutierrez introduced Mr. Pat Klein, Assistant Director, External Affairs, and Ms. Nancy Johnson, Rules Coordinator, to discuss the rulemaking. Ms. Johnson stated that on November 16, the Board approved the proposed notice of final rulemaking for Article 6, Public Participation in Rulemaking. This rule allows the public to have input in the rulemaking process. The final rulemaking is identical to the proposed rulemaking.

Motion: Mr. Jaime Gutierrez moved to approve the Notice of Final Rulemaking for Article 6, Public Participation in Rulemaking.

Mr. Chris Harris seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

6. Presentation, Discussion and Appropriate Action Regarding Notice of Final Rulemaking for R2-8-115, Return of Contributions Upon Termination of Membership by Separation from Service by Other than Retirement or Death; Payment of Survivor Benefits Upon the Death of a Member

Ms. Johnson stated that the notice of final rulemaking for R2-8-115 is actually an amendment to this rule. The purpose of this amendment is to remove a 21 day waiting period required of members before receiving a refund of contributions if they choose to terminate their membership.

Motion: Mr. Jaime Gutierrez moved to approve the Notice of Final Rulemaking for R2-8-115, Return of Contributions Upon Termination of Membership by Separation from Service by Other Than Retirement or Death; Payment of Survivor Benefits Upon the Death of a Member.

Mr. Chris Harris seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion passed.

7. Presentation, Discussion and Appropriate Action Regarding the Total Fund Performance Overview on the Period Ending 9/30/05

Mr. Terry Dennison, Principal, Mercer Investment Consulting, presented an overview of the Total Fund performance for the period ending September 30, 2005, highlighting specific areas of interest and concern.

Hurricanes Katrina and Rita made it difficult to interpret the data for the third quarter, but the Federal Government's preliminary report showed that growth was fairly robust. The initial government estimate of third-quarter Gross Domestic Product (GDP) growth was 3.8%.

For the quarter, industrial production was down 1.2% (and down 1.3% for September), retail sales were flat, and housing starts were up 2.1%. Tax receipts at the federal, state and municipal levels remain stronger than expected, indicating a healthy economy. The federal budget deficit declined for the first time in years. Currently, economic growth appears average, right around the 3.4% average growth rate since 1959. Non-consumer sectors such as IT and capital goods are very strong.

Inflation was at one of its highest levels in over a decade. Over the trailing year through September, the Consumer Price Index (CPI) was up 4.7%. Energy prices were the main culprit, as the energy component of the CPI was up 21.4% in the third quarter and up 34.8% over the trailing year. The inflation is not broad-based, which is why federal officials are concerned but not alarmed. Core CPI, which excludes food and energy prices is up 2.0% over the trailing year, right in line with its targets. The Producer Price Index was up 3.2% for the quarter and is up 6.9% over the trailing year.

Breakeven inflation increased during the quarter. In June, the breakeven inflation as measured by the difference between 10-year nominal and real yields was at 2.3%, but rose to 2.6% by the end of September. It has slipped back down to 2.5% since the beginning of the month. Going forward, 2.5% continues to the estimate of inflation for the next year as well as in the long run.

As expected, Ben Bernanke was nominated to replace Alan Greenspan as the new chairman of the Federal Reserve, and he should be easily confirmed by the Senate. Bernanke's overall approach will be very similar to Greenspan's. In the long run, Bernanke does face some considerable challenges. The recovery is getting "mature," real estate may be at a bubble phase, consumers are levered and saving is quite low, and the trade deficit is high.

Even amid the concerns about the impact of the hurricanes, federal officials believe that the economy is reasonably healthy at the moment. Energy prices, and to some extent low interest rates of the last few years, have had an inflationary effect, but this is a short-term phenomenon and should dissipate over the next year.

Federal Fund futures contracts imply that the federal government will raise interest rates to 4.25% by the end of the year and to 4.5% in the spring. Federal policy is finally moving into the restrictive range. Core inflation is around 2.0% to 2.5%, so we are beginning to see sizable short real interest rates.

Mr. Dennison reported on the Total Fund Performance for the period ending September 30, 2005.

	Quarter	1 Year	3 Years	5 Years	10 Years	Inception(6/30/75)
ASRS Total Fund	3.7%	12.9%	15.2%	3.0%	9.2%	10.9%
Benchmark*	3.5%	11.8%	14.5%	2.2%	7.9%	9.1%
Excess Return	0.2%	1.1%	0.7%	0.8%	1.3%	1.8%

*Interim Benchmark of 56% S&P 500/28% LB Aggregate/16% EAFE, which incorporates a proportion of 6% real estate.

8. Presentation, Discussion and Appropriate Action Regarding Domestic Mid Cap Equity Reporting on the Period Ending 9/30/05

Mr. Gary Dokes, Chief Investment Officer, presented the Domestic MidCap Equity Reporting for the period ending September 30, 2005. Mr. Dokes stated that as of October 31, 2005, the total market value of the ASRS MidCap asset class was \$1.3 billion, or approximately 6% of the ASRS total fund.

The Board terminated Forstmann-Leff and Frontier Capital as ASRS U.S. Equity active MidCap growth managers in August 2005, based on poor performance and a lack of confidence in the manager's ability to add value moving forward. Investment Management Division (IMD) transitioned the assets into the E3 passive growth portfolio until a replacement manager was identified. As a result of a manager search, the Board approved at the November 18, 2005 meeting the selection of NorthPointe Capital as an ASRS U.S. Equity MidCap Growth manager with \$140 million and an inception date of November 30, 2005.

Franklin Portfolio Associates outperformed the benchmark for the 3-year period and since inception. The portfolio underperformed the benchmark for the recent quarter and 1-year period. Mercer rates this product A (above average probability of outperformance).

Attribution Analysis for period ending September 30, 2005:

	Quarter	1 Year	3 Years	5 Years	Inception
Stock Selection	-256	-370	-12	---	16
Sector Selection	32	67	46	---	49
Other	-46	-87	-8	---	15
Fees	-2	-11	-20	---	-18
Excess Return	-272	-401	6	---	62

Wellington outperformed its benchmark and the universe median for all periods evaluated except the recent quarter. Mercer rates this product A (above average probability of outperformance).

Attribution Analysis for period ending September 30, 2005:

	Quarter	1 Year	3 Years	5 Years	Inception
Stock Selection	23	622	368	---	217
Sector Selection	-16	-207	-126	---	-84
Other	0	0	0	---	0
Fees	-15	-70	-70	---	-65
Excess Return	-8	345	172	---	68

Cramer Rosenthal McGlynn underperformed its benchmark for all periods except since inception. The portfolio placed above the universe median for the recent quarter and one year. Mercer rates this product A (above average probability of outperformance).

Attribution analysis for period ending September 30, 2005:

	Quarter	1 Year	3 Years	5 Years	Inception
Stock Selection	179	158	---	---	486
Sector Selection	-239	-137	---	---	-234
Other	0	0	---	---	0
Fees	-14	-54	---	---	-54
Excess Return	-74	-33	---	---	198

State Street Global Advisors is tracking the S&P MidCap 400 Index as expected. Mercer does not rate this product.

The Arizona State Retirement System E3 portfolio has tracked the S&P MidCap Growth closely for all periods evaluated. The Arizona State Retirement System E4 portfolio has tracked the S&P MidCap Value closely for all periods evaluated.

9. Presentation, Discussion and Appropriate Action Regarding the Coconino and Yavapai County HMO Update

Mr. Pat Klein provided an update to the Board regarding the Coconino and Yavapai County Rural Subsidy. The Board heard testimony at its October 21, 2005 meeting regarding the apparent inadequate number of PacifiCare contracted primary care physicians (PCPs) in Flagstaff, Arizona. At the direction of the Board, staff extended the open enrollment period to February 28, 2006, for Medicare eligible retired and disabled members who live in Coconino and Yavapai Counties. The extension would allow PacifiCare to add to its roster of contracted PCPs. As of October 21, 2005, PacifiCare had eight PCPs in the Flagstaff area. As of November 30, 2005, PacifiCare had increased the number of PCPs to 18 with an additional five PCPs progressing through PacifiCare's credentialing process.

10. Presentation, Discussion and Appropriate Action Regarding Policy Modifications and the Selection of Law Firms for Securities Litigation

Mr. Paul Matson addressed the Board regarding the selection and hiring of security litigation counsel. He explained that if the Board would like to engage in more than general discussion they would have to enter into an Executive Session. Mr. Matson also explained that final approval of the hiring of security litigation counsel rests with the Attorney General's office. Once the Board makes its decision, the Attorney General's Office will be notified and asked for final approval.

Mr. Matson also addressed the Board regarding policy modifications and selection of law firms for securities litigation. The ASRS receives compensation from class action litigation settlements associated with securities held in ASRS portfolios. Such litigation, and subsequent settlement, is currently the result of actions initiated by one or more interested holders of the related involved securities. Historically, the ASRS has not initiated legal action but has received the benefit of being a passive participating class action litigation member. The ASRS custodian bank is responsible for the monitoring, accounting and reporting of proceeds regarding class action litigation proceeds for securities held in ASRS portfolios.

Policies and Procedures (P&P) were presented to and approved by the Board in December 2004 which formalized the roles and responsibilities of all involved parties as it specifically relates to engaging in private action or accepting the role as lead plaintiff. Approval of such a P&P codified the process and infrastructure necessary to expeditiously implement Board directives intended to protect the ASRS' financial interests.

Consistent with the P&P, a Request for Proposal (RFP) was developed by staff with the assistance of the Arizona Attorney General and was issued in July 2005. Over a subsequent four months, staff evaluated the eighteen responses of which nine legal counsel firms were interviewed in the ASRS office. As a result, the Director, Investment Committee (IC) Chair and, as available, the CIO conducted on-site due diligence meetings with five short-listed legal counsel firms whom appeared to possess positive attributes deemed necessary to add value to the ASRS. The recommended three securities litigation legal counsel firms all possess a well-documented securities portfolio monitoring infrastructure, sound case evaluation process and experienced attorneys to effectively represent the interests of the ASRS.

The primary characteristics of the P&P are as follows:

- Improve the ASRS portfolio(s) review process by contracting with one or more external legal counsel 1) monitor ASRS holdings and evaluate all cases in which the ASRS is a possible member and quantify the estimated impact (losses) sustained, 2) evaluate whether the ASRS has sufficient losses to qualify and accept the role as a lead plaintiff or take private action, and 3) work with the ASRS and Arizona Attorney General's office to represent the ASRS as a lead plaintiff or taking private legal action.
- Establish a Securities Litigation Oversight Committee (SLOC) consisting of the Director, CIO, the Chair of the Investment Review Committee, or his/her designee, as voting members, and an Arizona Assistant Attorney General as an advisory member primarily

responsible for reviewing recommendations from external legal counsel and, as appropriate, for making recommendations to the Board for approval to accept lead plaintiff role, pursue private action and accept related settlement of claims.

- Define the essential required approvals 1) hiring of securities litigation legal counsel requires the approval of the Arizona Attorney General's office, 2) pursuing lead plaintiff status, take private action and accept settlement of claims requires the approval by the Board and Arizona Attorney General's office.

Motion: Mr. Larry Trachtenberg moved to approve selection and hiring of the following security litigation legal counsel firms:

- Bernstein Litowitz
- Berman De Valerio
- Cohen Milstein

And

Moved to approve the modified ASRS P&P which outlines the roles and responsibilities of the ASRS with respect to securities litigation activities and includes the following changes:

1. The Securities Litigation Oversight Committee (SLOC) shall be chaired by the executive director.
2. Recommended selections and terminations shall be changed from Board approval to SLOC and OCC approval.
3. The CIO will negotiate fees with the lead counsel to be approved by the SLOC.

Mr. Steve Zeman seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and excused, the motion passed.

Mr. Karl Polen left the meeting at 10:40 a.m.

11. Presentation, Discussion and Appropriate Action Regarding Material Dissemination and Overview of the ASRS Strategic Plan

Mr. Paul Matson presented the Strategic Plan. Mr. Matson explained that the Strategic Plan is being presented a few months before the discussion period in order for the Trustees to have time to read the packet. The general message of the packet is rooted in the plan to meet the ASRS' statutory purpose which is done through vision and values, investment principles, and goals and objectives. Facilitating elements of this plan include agency governance, strategic initiatives and business plans, management and performance, and budget and human resources.

Dr. Meredith suggested detailed reading of the packet in preparation for the February Board meeting and Mr. Dave Byers commented that spending some time in the committee meetings

preparing for the Board meeting would be a good idea. Ms. Anne Mariucci suggested using the idea of “where we’ve been, where we are, and where we’re going” with the emphasis on funded status to enhance the packet.

12. Presentation, Discussion and Appropriate Action Regarding Review of the Governance Handbook

Mr. Matson explained to the Board that discussion of the Governance Handbook is an annual process in which the handbook is reviewed and possible changes are considered.

Motion: Mr. Steve Zeman moved to approve the recommended, as amended by Board discussion, changes to the ASRS Board Governance Handbook.

Mr. Michael Townsend seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion passed.

13. Presentation, Discussion and Appropriate Action Regarding the Board Governance Evaluations

Dr. Meredith explained that the Board must conduct an annual self evaluation and overall board evaluation. Responses from the Trustees will be compiled and summarized for discussion at the February Board meeting.

14. Director’s Report

Mr. Matson summarized topics to be addressed in the coming months. February will bring a more detailed discussion of the strategic plan; discussion of the 2005 strategic initiative review, the 2006 strategic development, and possibly the defined benefit plan review. March will cover the system plan integration presentation, asset allocation research, and a strategic planning session. In April there will be a Trustee and Executive staff fiduciary education seminar.

15. Possible Presentation Regarding Board Committee Updates

Mr. Jaime Gutierrez, Chair, External Affairs Committee stated that the next External Affairs Committee meeting will take place in February, 2006.

Mr. Larry Trachtenberg, Chair, Investment Committee, stated that the next Investment Committee meeting will take place in February, 2006.

Mr. Michael Townsend, Chair, Operations Committee, stated that the next Operations Committee meeting will take place January 26, 2006 and will be reviewing the IT plan.

16. Board Requests for Agenda Items

There were no requests for agenda items.

17. Call to the Public

Mr. Clinton Bogard, retiree, addressed the Board. He stated that he thought the Board was doing a great job and offered his congratulations.

18. The next ASRS Board meeting is scheduled for Friday, February 17, 2006, at 8:30 a.m., at 3300 N. Central Avenue, 10th Floor Board room, Phoenix, Arizona.

19. Adjournment of the ASRS Board

Dr. Meredith adjourned the December 16, 2005 Board meeting at 11:04 a.m.

ARIZONA STATE RETIREMENT SYSTEM

Anne Schrode, Secretary

Date

Paul Matson, Director

Date